

[Release No. 34-35431; File No. SR-CHX-95-04]

Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval to Proposed Rule Change by Chicago Stock Exchange, Inc. Relating to an Extension of a Pilot Program for Stopped Orders in Minimum Variation Markets

March 1, 1995.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on February 8, 1995, the Chicago Stock Exchange, Inc. ("CHX" or "Exchange") filed with the Securities and Exchange Commission ("Commission" or "SEC") the proposed rule change as described in Items I and II below, which Items have been prepared by the self-regulatory organization. The CHX has requested accelerated approval of the proposal. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The Exchange proposes to extend the pilot program for stopped orders in minimum variation markets for an additional four (4) month period. This is the fourth requested extension of the pilot, originally approved on January 14, 1992.³ The first requested extension of the pilot was approved on March 10, 1993.⁴ The second requested extension of the pilot was approved on June 11, 1993.⁵ The third requested extension of the pilot was approved on March 21, 1994.⁶ The pilot program is set to expire on March 21, 1995. The Exchange has submitted its current monitoring report under separate cover. The report covers the period December 20, 1994 through January 20, 1995 and includes detailed data for January 4, 1995.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the self-regulatory organization included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item III below. The self-regulatory organization has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The purpose of the proposed rule change is to extend the pilot program implemented to establish a procedure regarding the execution of "stopped" market orders in minimum variation markets (usually an $\frac{1}{8}$ th spread market). In 1992, the Exchange adopted interpretation and policy .03 to Rule 37 of Article XX, on a pilot basis, to permit stopped market orders in minimum variation markets.⁷ Prior to the pilot program, no Exchange rule required specialists to grant stops in minimum variation markets if an out-of-range execution would result. While the Exchange has a policy regarding the execution of stopped market orders generally, the Exchange believes it is necessary to establish a separate policy for executing stopped market orders when there is a minimum variation market.

The Exchange's general policy regarding the execution of stopped orders is to execution them based on the next primary market sale. If this policy were used in a minimum variation market, it would cause the anomalous result of requiring the execution of all pre-existing orders, even if those orders are not otherwise entitled to be filled.⁸

The Exchange's proposed policy would prevent unintended results by continuing a pilot program, established in 1992, for stopped market orders in minimum variation markets.⁹ Specifically, the pilot program would require the execution of stopped market orders in minimum variation markets after a transaction takes place on the primary market at the stopped price or worse (higher for buy orders and lower for sell orders), or after the applicable Exchange share volume is exhausted. In no event would a stopped order be executed at a price inferior to the stopped price.¹⁰ In the Exchange's view, the proposed policy would continue to benefit customers because they might receive a better price than the stop price, yet it also protects Exchange specialists by eliminating their exposure to executing potentially large amounts of pre-existing bids or offers when such executions would otherwise not be required under Exchange rules.

2. Statutory Basis

The Proposed rule change is consistent with Section 6(b) (5) in that it is designed to promote just and equitable principles of trade.

B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange believes that no burdens will be placed on competition as a result of the proposed rule change.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants or Others

No comments were received.

rules of priority and precedence. This is so even though the pre-existing bids were not otherwise entitled to be filled.

In the above example, Exchange Rule 37 (Article XX) requires the Exchange specialist to fill orders at the limit price only if such orders would have been filled had they been transmitted to the primary market. Therefore, the 100 share print at 20 in the primary market would cause at most 100 of the 5,000 share limit order to be filled on the Exchange. However, the Exchange's general policy regarding stopped orders, if applied to minimum variation markets, would require the 100 share stopped market order to be filled, and, as a result, all pre-existing bids at the same price to be filled in accordance with Exchange Rule 16 (Article XX).

⁹See 1992 Approval Order, *supra*, note 3.

¹⁰Exchange Rule 28 (Article XX) states.

An agreement by a member or member organization to "stop" securities at a specified price shall constitute a guarantee of the purchase or sale by him or it of the securities at the price or its equivalent in the amount specified. If an order is executed at a less favorable price than that agreed upon, the member or member organization which agreed to stop the securities shall be liable for an adjustment of the differences between the two prices.

¹ 15 U.S.C. 78s(b)(1) (1988).

² 17 CFR 240.19b-4 (1991).

³ See Securities Exchange Act Release No. 30189 (January 14, 1992), 57 FR 2621 (January 22, 1992) (File No. SR-MSE-91-10) ("1992 Approval Order").

⁴ See Securities Exchange Act Release No. 31975 (March 10, 1993), 58 FR 14230 (March 16, 1993) (File No. SR-MSE-93-04) ("March 1993 Approval Order").

⁵ See Securities Exchange Act Release No. 32457 (June 11, 1993), 58 FR 33681 (June 18, 1993) (File No. SR-MSE-93-14) ("June 1993 Approval Order").

⁶ See Securities Exchange Act Release No. 33790 (March 21, 1994), 59 FR 14434 (March 28, 1994) (File No. SR-CHX-93-30) ("1994 Approval Order").

⁷ See 1992 Approval Order, *supra*, note 3.

⁸ For example, assume the market in ABC stock is 20-20 $\frac{1}{8}$; 50 x 50 with $\frac{1}{8}$ th being out of range. A customer places an order with the Exchange specialist to buy 100 shares of ABC at the market, and a stop is effected. The order is stopped at 20 $\frac{1}{8}$, and the Exchange specialist includes the order in his or her quote by bidding the 100 shares at 20. If the next sale on the primary market is for 100 shares at 20, adopting the Exchange's existing general policy to minimum variation markets would require the specialist to execute the stopped market order at 20. However, because the stopped market order does not have time or price priority, its execution would trigger the requirement for the Exchange specialist to execute all pre-existing bids (in this case, 5,000 shares) based on the Exchange's

III. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street NW., Washington, DC 20549. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying at the Commission's Public Reference Section, 450 Fifth Street, NW., Washington, DC 20549. Copies of such filing will also be available for inspection and copying at the principal office of the CHX. All submissions should refer to File No. SR-CHX-95-04 and should be submitted by March 29, 1995.

IV. Commission's Findings and Order Granting Accelerated Approval of Proposed Rule Change

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange and, in particular, with Section 6(b)(5)¹¹ and Section 11(b)¹² of the Act. The Commission believes that proposed interpretation and policy .03 to Rule 37 should further the objectives of Section 6(b)(5) and Section 11(b) through pilot program procedures designed to allow stops, in minimum variation markets, under limited circumstances that offer primary market price protection for customers whose orders are granted stops, while still adhering to traditional auction market rules of priority and precedence.¹³

In its orders approving the pilot procedures,¹⁴ the Commission asked the CHX to study the effects of stopping stock in a minimum variation market. Specifically, the Commission requested information on (1) the percentage of

orders which received an out-of-range execution despite having been stopped; (2) whether limit orders on either side of the specialist's book were bypassed due to the execution of stopped orders at a better price (and to this end, the Commission requested that the CHX conduct a one-day review of all book orders in the five stocks receiving the greatest number of stops); and (3) specialist compliance with the pilot program's procedures.

The Exchange has submitted to the Commission several monitoring reports regarding its proposed interpretation of Rule 37. The Commission believes that, although these monitoring reports provide certain useful information concerning the operation of the pilot program, the Commission must conduct further analysis of the CHX data and, in particular, of the rule's impact on limit orders on the specialist's book before it can consider permanent approval thereof. To allow the Commission fairly and comprehensively to evaluate the CHX's use of its pilot procedures, without compromising the benefit that investors might receive under Rule 37, as amended, the Commission believes that it is reasonable to extend the pilot program until July 21, 1995.

First, the Exchange's latest monitoring report indicates that relatively few orders received an out-of-range execution despite having been stopped and, thus, did not benefit from the CHX proposal.¹⁵ The Commission believes that the pilot procedures provide a benefit to certain investors by offering primary market price protection to customers whose orders are granted stops in minimum variation markets. According to the CHX report, moreover, virtually all stopped orders were for 2,000 shares or less. In this respect, the proposed amendments should mainly

¹⁵ The Commission notes that this pilot program is intended to prevent orders from being executed outside the primary market range for the day (i.e., from establishing a new high or new low). Consistent with that policy, the CHX requires the specialist to execute stopped stock based on the next primary market sale. Specifically, if the next sale is at a better price, the stopped stock may, depending on the depth of the specialist's limit order book at that price, receive price improvement. However, if the next primary market sale is at the stop price (or worse), the order can receive the stop price. If an order is executed at the stop price because the next sale creates a new primary market range, the pilot program may still have provided a benefit to investors, by preventing what would have been an out-of-range execution.

Conversely, an order may not benefit from the CHX proposal if, despite having been stopped, it ultimately receives an out-of-range execution. In a minimum variation market, this can occur if, by the close, (1) the primary market has not traded at the stop price and (2) all pre-existing limit orders on the CHX specialist's book at the better price have not been executed.

affect small public customer orders, which the Commission envisioned could most benefit from professional handling by the specialist.

Second, the CHX does not appear to believe that its proposed policy significantly disadvantages customer limit orders existing on the specialist's book.¹⁶ This conclusion is based on the Exchange's analysis of limit orders on the opposite side of the market at the time a stop was granted pursuant to the pilot program. As part of its analysis (which included a one-day review of the five stocks receiving the greatest number of stops), the CHX determined how often book orders which might have been entitled to an execution had the order not been stopped, in fact, were executed at their limit price by the close of the day's trading. In addition to aggregated data, the Exchange provided a detailed breakdown of the disposition of each order.

The Commission historically has been concerned that book orders may be bypassed when stock is stopped, especially in a minimum variation market.¹⁷ Based on the CHX's prior experience, the Commission did not have sufficient grounds to conclude that this long-standing concern had been alleviated. The Commission acknowledges, however, that the CHX's latest monitoring reports provide new information on this aspect of the pilot program. As a result, the Commission finds that additional time is necessary for the Commission to review such information and to ensure that Rule 37, as amended, does not harm public customers with limit orders on the specialist's book.

As for book orders on the same side of the market as the stopped stock, the Commission believes that the proposed requirements make it unlikely that these limit orders would be bypassed. Under the Exchange's pilot procedures, a stopped order can receive price improvement only if all preexisting CHX share volume at that price has been exhausted.

As for the pilot program's effect on limit orders on the same side of the market as the stopped stock, the CHX report suggests that a substantial majority of limit orders at the bid (for

¹⁶ When stock is stopped, book orders on the opposite side of the market that are entitled to immediate execution lose their priority. If the stopped order then receives an improved price, limit orders at the stop price are bypassed and, if the market turns away from that limit, may never be executed.

¹⁷ See, e.g., SEC, Report of the Special Study of the Securities Markets of the Securities and Exchange Commission, H.R. Doc. No. 95, 88th Cong., 1st Sess. Pt. 2 (1963). Commission, H.R. Doc. No. 95, 88th Cong., 1st Sess. Pt. 2 (1963).

¹¹ 15 U.S.C. 78f (1988).

¹² 15 U.S.C. 78f (1988).

¹³ For a description of CHX procedures for stopping stock in minimum variation markets, and of the Commission's rationale for approving those procedures on a pilot basis, see 1992 Approval Order, *supra*, note 3. The discussion in the aforementioned order is incorporated by reference into this order.

¹⁴ See *supra*, notes 3-6.

stopped buy orders) or offer (for stopped sell orders) with time priority were executed by the close. The Commission recognizes the unintended consequences that can arise from the interplay between a regional exchange's price protection rules and its procedures for stopping stock.¹⁸ In the Commission's opinion, the CHX data suggests that stopped stock generally has been executed in accordance with traditional auction market principles.

Finally, the CHX has responded to the Commission's questions about compliance with the pilot program procedures; at this time, the Exchange staff is not aware of any market surveillance investigations or customer complaints relating to the practice of stopping stock in minimum variation markets.¹⁹ In the event, however, that the CHX identifies any instances of specialist noncompliance with the pilot procedures, the Commission would expect the Exchange to take appropriate action in response.

During the pilot extension, the Commission requests that the Exchange continue to monitor the effects of stopping stock in a minimum variation market and to provide additional information where appropriate. In addition, if the Exchange determines to request permanent approval of the pilot program or an extension thereof beyond July 21, 1995, the CHX should submit to the Commission a proposed rule change by April 15, 1995.

The Commission finds good cause for approving the proposed rule change prior to the thirtieth day after the date of publication of the notice of filing thereof. This will permit the pilot program to continue on an uninterrupted basis. In addition, the procedures the Exchange proposes to continue using are the identical procedures that were published in the **Federal Register** for the full comment period and were approved by the Commission.²⁰

It is therefore ordered, pursuant to Section 19(b)(2)²¹ that the proposed rule change (SR-CHX-95-04) is hereby approved on a pilot basis until July 21, 1995.

¹⁸ See *supra*, note 8 and accompanying text.

¹⁹ Telephone conversation between David T. Rusoff, Foley & Lardner, and Beth A. Stekler, Attorney, Division of Market Regulation, SEC, on February 28, 1995.

²⁰ No comments were received in connection with the proposed rule change which implemented these procedures. See 1992 Approval Order, *supra*, note 4.

²¹ 15 U.S.C. 78s(b)(2) (1988).

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²²

Margaret H. McFarland,

Deputy Secretary.

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[Release No. 34-35427; File No. SR-MSRB-94-10]

Self-Regulatory Organization; The Municipal Securities Rulemaking Board; Order Approving Proposed Rule Change Establishing Three Business Day Settlement Time Frame

February 28, 1995.

On August 9, 1994, the Municipal Securities Rulemaking Board ("MSRB") submitted a proposed rule change to the Securities and Exchange Commission ("Commission") pursuant to Section 19(b) of the Securities Exchange Act of 1934 ("Act").¹ Notice of the proposal appeared in the **Federal Register** on August 24, 1994.² The Commission received four comment letters.³ This order approves the proposal.

I. Description of the Proposal

The purpose of the proposed rule change is to establish three business days after execution of a trade ("T+3") as the standard settlement time frame for transactions in municipal securities. The proposal conforms the standard settlement time frame for municipal transactions to that for most other equity and debt securities transactions.⁴ Currently, regular-way settlement is defined as five business days ("T+5") in

²² 17 CFR 200.30-3(a)(12) (1991).

¹ 15 U.S.C. 78s(b) (1988).

² Securities Exchange Act Release No. 34541 (August 17, 1994), 59 FR 43603.

³ Letters from R.N. Dillingham to Commissioners, Commission (September 12, 1994); Sarah A. Miller, Senior Government Relations Counsel, Trust and Securities, American Bankers Association, to Jonathan G. Katz, Secretary, Commission (September 14, 1994); P. Howard Edelstein, President, Electronic Settlement Group, Thomson Trading Services, Inc. (A Thomson Financial Services Company), to Jonathan G. Katz, Secretary, Commission (September 16, 1994); and Diane M. Butler, Director—Operations & Fund Custody, Investment Company Institute, to Jonathan G. Katz, Secretary, Commission (September 22, 1994). In addition, the MSRB received six comment letters prior to filing the proposed rule change with the Commission. See *infra* note 7.

⁴ On October 6, 1993, the Commission adopted Rule 15c6-1 under the Act which establishes T+3 as the standard settlement cycle for most broker-dealer transactions. Rule 15c6-1 does not apply to transactions in municipal securities. While municipal securities were specifically exempt from the scope of the rule, the Commission stated its expectation that the MSRB would take the lead in moving municipal securities to a T+3 settlement time frame. Securities Exchange Act Release No. 33023 (October 6, 1993), 58 FR 52891.

MSRB rules G-12 ("Uniform Practice") and G-15 ("Confirmation, Clearance and Settlement Transactions with Customers"). The proposed rule change will be effective on June 7, 1995, the same day as the Commission's Rule 15c6-1.⁵

The proposed rule change allows alternate settlement time frames for municipal securities transactions in the secondary market by agreement of the parties at the time of each individual transaction. Thus, broker-dealers may not use standing instructions or master agreements to retain T+5 settlement as a standard practice.

The proposed rule change does not alter the current practice with respect to "when, as and if issued" transactions.⁶ Currently, "when, as and if issued" transactions are not settled in five business days due to the various actions necessary to accomplish settlement with the issuer of municipal securities. Therefore, rule G-12(b) will continue to provide that "when, as and if issued" transactions will settle on a date agreed to by both parties but not earlier than the fifth day following the date the confirmation indicating the final settlement date is sent or the sixth day following the date the confirmation indicating the final settlement date is sent for transactions between a manager and a syndicate member.

The proposed rule change also will amend rule G-15(d)(i) relating to institutional customer delivery instructions on delivery versus payment or receipt versus payment ("DVP/RVP") settlements to reflect a T+3 rather than T+5 settlement cycle. Pursuant to the amendment, a broker-dealer must obtain a representation from a customer with DVP/RVP privilege that the customer will deliver instructions to its agent with respect to the receipt or delivery of the securities involved in the transaction promptly and "in a manner to assure that settlement will occur on settlement date." The MSRB has deleted references to specific agent instruction time frames.

II. Written Comments

In addition to the six comment letters the MSRB received prior to the filing of its proposal,⁷ the Commission received

⁵ Rule 15c6-1, as adopted, was to become effective June 1, 1995. In order to provide for an orderly and efficient transition from T+5 settlement to T+3 settlement, the Commission has changed the effective date of Rule 15c6-1 to June 7, 1995. Securities Exchange Act Release No. 34952 (November 9, 1994), 59 FR 59137.

⁶ "When, as and if issued" transactions are transactions in municipal securities which have not yet been issued.

⁷ Letters from W. Pat Connors, Connors & Co., Inc., to Judy Somerville, MSRB (March 25, 1994);